



DEPARTMENT OF THE NAVY
SPACE AND NAVAL WARFARE SYSTEMS COMMAND
WASHINGTON, D.C. 20363-5100

SPAWARINST 4920.5

SPAWAR 003

9 January 1990

SPAWAR INSTRUCTION 4920.5

From: Commander, Space and Naval Warfare Systems Command

Subj: RECOVERY OF NONRECURRING COSTS FOR U.S. NAVY DEVELOPED
HARDWARE/SOFTWARE/MODIFICATION KITS/TECHNOLOGY

Ref: (a) DOD Directive 2140.2 w/change 1 of 27 Jul 87
(b) DODINST 7290.3M, Chapter 7
(c) DOD FAR Supplement, Parts 235 and 252, Contract
Clause on Recovery of Nonrecurring Costs on
Commercial Sales, DFAR 252.235-7002, Feb 80
(d) Security Assistance Management Manual (SAMM),
Chapter 7 with Revision 9 of 31 Jul 87

Encl: (1) Definition of Nonrecurring Production and
Nonrecurring RDT&E Costs
(2) Directions for Calculating Charges, Nonrecurring
Costs

1. Purpose. To ensure that non-U.S. Government customers are assessed a fair charge for the value of nonrecurring costs of hardware, software, modification kits and technology developed by the U.S. Navy or, in special cases, by a Foreign Military Sales (FMS) customer.

2. Applicability and Scope

a. This instruction applies to all SPAWAR activities and offices involved in the programming, contracting, developing, producing or selling of SPAWAR hardware, software, modification kits and technology using DOD RDT&E or procurement funds.

b. Direction to recoup nonrecurring costs shall apply contractually to SPAWAR contractors, to subcontractors via directed flow-down, and to organizations receiving technical data packages (TDPs) from SPAWAR. It applies to those who sell, or use technology to manufacture and sell, defense items to a foreign government, an international organization, or a foreign commercial firm or to a domestic organization or private party, all collectively called customers.

3. Policy

a. In accordance with DOD policy, SPAWAR acquisition managers are directed to recover a fair share of the DOD investment in nonrecurring costs related to SPAWAR products or technology when the products are sold and when technology relating to the manufacture of the products is sold or licensed to foreign or domestic customers.

SPAWAR INSTRUCTION 4920.5

9 January 1990

b. The recoupment charge payable by non-U.S. Government customers shall be determined in accordance with references (a) and (b).

c. Following the procedures set forth in reference (a), the clause cited in reference (c) shall be incorporated in all RDT&E and production contracts and subcontracts valued in excess of \$1 million. Prime contractors will invoke the clause via flow-down to subcontractors for significant subassemblies or major components with value in excess of \$1 million.

4. Responsibilities

a. SPAWAR 003 shall be responsible for serving as the point-of-contact to coordinate and respond to actions on the establishment of nonrecurring costs of sales of U.S. Government products and technology by U.S. contractors to a foreign government or a foreign commercial source.

b. Program Directors shall be responsible for:

(1) Requesting the Procuring Contractor Officer (PCO) to obtain a record of commercial sales from the contractor.

(2) Ensuring that acquisition managers are informed about the following:

(a) The need to recoup a portion of nonrecurring costs from contractors and subcontractors.

(b) Upon reporting physical delivery of items in a case to the Navy International Logistics Control Office (NAVILCO), also report the applicable amount of nonrecurring recoupment charges (NRC) and request billing for the NRC. This involves cases which are in the Management Information System for International Logistics (MISIL).

c. Acquisition Managers with primary cognizance for RDT&E or production of SPAWAR articles and technology shall be responsible for ensuring that the appropriate charges for recoupment of nonrecurring costs are determined in accordance with reference (a). Enclosures (1) and (2) may be used as guides for developing the charges for recoupment of nonrecurring costs. The Acquisition Contract Officer (ACO) should report to SPAWAR 003M any apparent contract non-compliance with requirements for the clause, as in reference (c), included in contracts.

d. Foreign Military Sales (FMS) Case Managers shall be responsible for the following procedure for processing billings for FMS cases maintained in the Standardized Accounting and Reporting System (STARS):

9 January 1990

(1) Have the acquisition manager generate NAVMAT Form 7042/1 to obligate money for nonrecurring costs.

(2) Have the acquisition manager prepare NAVCOMPT Form 2277 (Voucher for Disbursement and/or Collection).

(3) Forward Form 2277 to SPAWAR 01-4 for signature, release, and to enter the results in STARS.

e. SPAWAR 02 shall be responsible for:

(1) Upon award of a contract that may result in domestic or foreign commercial sales of an article or technology developed with government funds, advising the contractor in writing with a copy to the Program Director and to SPAWAR 003 of the:

(a) Applicable nonrecurring recoupment charge or that a recoupment charge is applicable and will be collected.

(b) Need to notify SPAWAR when domestic or foreign sale of the article, or a similar article, is contemplated.

(2) Directing the Acquisition Contract Officer (ACO) to advise the contractor in writing of the address code in the NAVILCO to which checks will be sent.

(3) In accordance with reference (a), ensuring that contracting officers insert the clause 252.235-7002 of reference (c).

(4) Reviewing and forwarding promptly with comments to SPAWAR 003 any request for waiver of charges for domestic sales and providing a recommendation whether to approve or disapprove the waiver.

(5) Reporting to SPAWAR 003 and to the Program Director when it is apparent that commercial sales are taking place but are not being reported as required.

f. SPAWAR 00G shall be responsible for making recovery of nonrecurring costs on commercial sales a special interest item for command inspections.

5. Procedures

a. SPAWAR 003 shall:

(1) Annually send to acquisition managers a list of approved Major Defense Equipment (MDE) and Non-Major Defense Equipment (non-MDE) charges applicable to SPAWAR acquisitions.

SPAWAR INSTRUCTION 4920.5

9 January 1990

(2) Maintain a database of SPAWAR MDE and non-MDE which will display for each item of equipment, technology (including software), and production items the cost, the approved recoupment charges, the cognizant command or office in SPAWAR, and an account of actions taken on the charges for each item.

(3) Keep acquisition managers advised of the appropriate charges for MDE and non-MDE, technology, special costs and modification kits.

(4) Promulgate policy on nonrecurring cost recoupment and coordinate modification or development of policy or procedures with the Navy Office of Technology Transfer and Security Assistance (NAVOTTSA).

(5) Coordinate with the appropriate Program Directorate (PD) each request for a munitions export license and each proposal for a foreign military sale submitted to SPAWAR to ensure that, where applicable, each addresses nonrecurring cost recoupment in accordance with reference (d).

(6) Initiate periodic reviews of SPAWAR equipments to evaluate them for nonrecurring cost applicability.

(7) If warranted, prepare a request to NAVOTTSA for consideration of a revised recoupment charge.

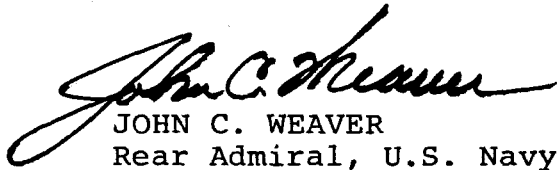
b. SPAWAR 02 shall:

(1) When requested by the PD/Acquisition Manager (PMW) incorporate the clause as in reference (c) into every contract that may result in domestic or foreign commercial sales of an article or technology which provides for recovery of nonrecurring costs.

(2) When notified by 003 advise SPAWAR contractors, in writing with a copy to 003, of approved recoupments, including recoupments where the assessment of the charge is zero.

(3) Have contracting officers and contracting officer's technical representatives advise contractors that failure by the government to provide the contractor with an approved nonrecurring recoupment charge does not relieve the contractor of responsibility to notify the contracting officer of any potential commercial sale of articles and/or technology developed with government funds.

(4) Report any knowledge of plans to sell or of sales of items subject to recoupment to the Contracting Officer and to SPAWAR 003.


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SPAWAR INSTRUCTION 4920.5
9 January 1990

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NONRECURRING PRODUCTION AND NONRECURRING RDT&E COSTS
(Adapted from DOD 7290.3-M, Section 70205)

A. DEVELOPMENT COSTS

Advanced development (6.3) is sometimes broken down into 6.3A for research efforts that involve the production of breadboards or brassboards to model all or part of a design and 6.3B projects to produce a prototype of an end-item for military application. Costs incurred for nonrecurring R&D in classification 6.3A may not be included in the nonrecurring RDT&E cost pool. However, costs in classification 6.3B, and 6.4 and the remaining R&D classifications are subject to recoupment and shall be included in the nonrecurring R&D cost pools upon which the pro rata charge is calculated.

B. PRODUCTION COSTS

The costs to be included in the nonrecurring production cost pool are those financed now or in the future by procurement or operations and maintenance appropriations that benefit current and future production runs. Such costs are preproduction, special tooling, special testing equipment, production engineering, product improvement, destructive testing and product model production, and testing and evaluation. Other costs may be included if they benefit both current and future production runs. The major categories of costs to be accumulated in this nonrecurring cost pool are:

1. Preproduction Cost of such activities as tool manufacture and tryout (such as jigs, dies, and fixtures) and the implementation of plant layout plans.

2. Special Tooling Cost of all jigs, dies, fixtures, molds, patterns, taps, gauges, other equipment and manufacturing aids, and replacements that are of such a specialized nature that substantial modifications or alteration of their use is limited to the development or production of particular supplies or parts, or the performance of particular services.

3. Special Test Equipment Cost for either single or multipurpose integrated test units engineered, designed, fabricated, or modified to accomplish special purpose testing in the performance of the contract. Such testing units comprise electrical, electronic, hydraulic, pneumatic, mechanical, or other items or assemblies of equipment that are mechanically, electrically, or electronically interconnected.

4. Developmental Production Engineering Cost of product design improvements intended to enhance producibility of an item; an examination of available manufacturing processes to determine the need for new techniques (and their development, if

SPAWARINST 4920.5

9 January 1990

necessary); the optimum marshalling of resources for efficient manufacturing (such as optimum lot size, scheduling, production control, production line design and balancing, and plant layout); and tool design and detailed manufacturing planning.

5. Product Improvement Cost is subdivided into: (a) safety; (b) cost reduction; (c) reliability, availability, and maintainability; (d) deficiency corrections; (e) compatibility, standardization, and simplification; and (f) new or improved operational capability. Categories (a) through (e) are to be included in the end item nonrecurring production cost pool, unless a participating product improvement program has been established that prorates annual cost of the program based upon worldwide asset position (both U.S. and foreign-owned end items). The cost of category (f) shall be recovered as part of the selling price of a modification kit, if the established threshold for recoupment action has been met. Product improvement programs may be accomplished by contractors as an engineering change proposal (ECP), modification work order (MWO), or as an in-house project.

6. Destructive Testing Cost for performing tests on a component, assembly, or an end item beyond its design limits (and ultimately its destruction), or the actual consumption of the article to determine if it is performing to design specifications.

7. Pilot Model Testing Cost for the following efforts:

a. Qualification Testing Cost to determine if a product will do what it is designed to do. It usually involves the testing of a product to the limits of its performance. It is often destructive and the test articles are not intended to be used operationally.

b. First Article Testing Cost to evaluate a new manufacturer's ability to produce a specified design (could be the new manufacturer's design or that of another manufacturer). It is normally more stringent and costly than routine acceptance testing, but less stringent and costly (and less destructive) than qualifications testing.

8. License Cost of the license DOD obtains to allow competitive awards for production of an item when its design is owned by a contractor. In effect, the Department of Defense buys the rights to allow other contractors to produce an item for DOD purposes through the payment of royalties or a lump sum fee. These royalties are customarily on a per item basis and should be charged as recurring production costs. The lump sum fee is a nonrecurring production cost.

C. USG USE ONLY

In computing nonrecurring cost pools for items to be sold under FMS or direct commercial transactions, nonrecurring costs for major components that are restricted to U.S. Government use only shall not be included. For example, the costs of nuclear devices and features, countermeasure devices and features, security devices (black boxes), carrier-peculiar adaptations, and special fuel tank devices shall be excluded.

DIRECTIONS FOR CALCULATING CHARGES, NONRECURRING COSTS
(Adapted from DOD INSTR 2140.2 with Change 1, dated 27 July 1987)

A. GENERAL

1. The nonrecurring costs (NC) recoupment charge shall be based upon information recorded in DOD accounting records of DOD budget justification documents.
2. Once the approved charge has been used in an authorized sale, the charge normally will not be revised until a model change occurs or a major new development program occurs that changes the operational capability of the end item.
3. Components are not to be sold or purchased separately for ultimate assembly as an end item in an attempt to circumvent payment of NC charges.
4. The established NC recoupment charge shall be included in the FMS unit price, or, for commercial sales, provided to the seller, and paid by the seller to the U.S. Government (USG).

B. DEFINITIONS

1. Major Defense Equipment (MDE). Any item of significant combat equipment on the United States Munitions List having a nonrecurring RDT&E cost of more than \$50 million or a total production cost of more than \$200 million.
2. Model. A basic alphanumeric designation within a weapon series, such as an equipment or system series. For example, the AN/SSC-1 and the AN/SSC-2 are different models of SATCOM terminals within the same AN/SSC system series.
3. Non-Major Defense Equipment (Non-MDE). Any item of equipment or component that is not identified as major defense equipment.
4. Nonrecurring Production Costs. Those one-time costs incurred in support of previous production of the model specified and those costs specifically incurred in support of the total projected production run, described in enclosure (1).
5. Nonrecurring Research, Development, Test, and Evaluation (RDT&E) Costs. Those costs funded by an RDT&E appropriation to develop or improve the product or technology under consideration either through contract or in-house effort, described in enclosure (1).

Enclosure (2)

6. Pro Rata Recovery of Nonrecurring Costs (NC). Equal distribution (proration) of a pool to a specific number of units that benefit from the investment so that a DOD Component will collect from a customer a fair (pro rata) share of the investment in the product being sold.

7. "Special" RDT&E and Nonrecurring Production Costs. Costs incurred at the request of, or for the benefit of, the customer in developing a special feature or unique requirement. These costs must be paid by the customer as they are incurred.

8. Technology. Information of any kind that can be used or adapted for use in the design, production, manufacture, utilization, or reconstruction of articles or material. The data may take a tangible form, such as a scale model, prototype, blueprint, or an operating manual, or may take an intangible form, such as technical advice.

C. CALCULATION OF CHARGES ON MAJOR DEFENSE EQUIPMENT (MDE) AND COMPONENTS

1. The determination of whether an item meets the MDE dollar threshold shall be based on obligations recorded to the date the equipment is offered for sale. For the FMS program, the sales offer date shall be the date a Letter of Offer and Acceptance (LOA) is signed by a U.S. official and released to the FMS customer; for commercial sales, the sales offer shall be the date of contract signature.

2. NC recoupment charges shall be assessed on a pro rata basis. The charges shall be established by dividing the total of all applicable NC costs, including costs of in-house performance or multiple procurements incurred to date plus projections of future costs to be incurred, by the total estimated number of units projected to be produced over the life of the system (including DOD requirements and direct commercial sales requirements). All applicable NC efforts, including in-house contractors, shall be included in the NC cost pool.

3. The number of units to be produced for DOD shall be obtained from budget backup data. FMS quantity projections and direct commercial sales quantity projections shall be derived jointly as best estimates by the Navy and DSAA. Defense contractors should be consulted in determining direct commercial sales quantities, if necessary. When disagreement on estimated FMS and direct commercial quantities and sales projections occur, the Director, DSAA, will make the final determination.

4. For a weapon system that includes more than one component that meets the MDE threshold or contains a component that has application to several weapons systems or a commercial sale potential, referred to here as a major individual component, a "building block" approach (that is the sum of NC recoupment charges for individual components) shall be used to determine the NC recoupment charge for the sale of the entire system.

a. Data must be accumulated for each major component when NC is identified in accounting records or budget documents. The sum of the various component NC recoupment charges and any remaining NC for the weapon system shall be applied to the sale of the complete system. Individual NC recoupment charges shall be applied to sales of individual components.

b. When a model change occurs, the NC recoupment charge shall be recalculated. That portion of the NC which benefits only one model shall be allocated only to that model; i.e., old or new. That portion of the NC that benefits old and new models shall be prorated between cost pools related to the old and new model items.

c. Commonality between old and new models may be determined either on the basis of the ratio of model parts in the new or on some other commonly acceptable basis for allocation of costs between the models; i.e., engineering analysis or technology analysis, as appropriate.

5. If a commercial item being sold is substantially different (less than 90 percent common) from the USG item for which the NC recoupment charge was developed, the charge shall be assessed based on the extent of commonality with the USG item. For example, if the commercial item is 25 percent common with the DOD item, then only 25 percent of the established NC recoupment charge for the DOD item shall be assessed.

D. CALCULATION OF CHARGES ON NON-MAJOR DEFENSE EQUIPMENT

NC recoupment charges on non-MDE shall be established in accordance with the following procedures. Once established, the charge normally shall not be revised unless the item subsequently qualifies as an MDE item. When a non-MDE item becomes an MDE item, a new NC recoupment charge shall be established using MDE procedures.

1. Components of MDE Items. The pro rata amount, as determined through use of the building block approach, shall be assessed whenever a major component is sold.

2. Non-MDE End Items. A percentage NC recoupment charge shall be assessed on non-MDE end items costing over \$2 million in RDT&E funds. The applicable surcharge shall be 5 percent of the item's current DOD inventory price.

3. Modification Kits

a. Developed to Provide an End Item With New or Improved Capability. An NC percentage charge shall be made whenever \$2 million of RDT&E, procurement, or O&M funds have been expended on engineering, development, or testing of the kit. The applicable surcharge shall be 5 percent of the selling price of modification kits transferred under the FMS program or sold commercially by U.S. contractors.

b. Developed to Improve the Safety, Reliability, Availability, and Maintainability. The costs of improvement programs that are designed to continuously improve the safety, reliability, availability, and maintainability of an end item or major component over the projected life of the item will be shared equitably by all users of the item. Normally, each user will pay a share of the total annual cost through a Component Improvement Program (CIP) or comparable program. All users are expected to participate in such programs. However, if a user does not participate in a CIP or comparable program, the user will pay an appropriate share of the development costs of any modification purchased after delivery of the system. The calculation of these charges is as follows:

(1) New Item. For new items entering the system the cost sharing calculation will be established at the time the NC cost pool is established and the NC recoupment charge is approved. First, the total life of the item will be projected, then the point-in-time when half of all projected deliveries to non-DOD customers will occur. Using actual cost data and data from historical files for comparable programs, the total U.S. investment costs over the life of the program will be estimated. The amount of U.S. investment projected to be incurred up to the previously determined point of half of the deliveries to non-DOD customers will be included in the weapon system NC cost pool. The annual cost of operating will be shared in proportion to the number of items in the possession of each user to ensure that the remaining costs of operating will be shared equally by all users of the item.

(2) Existing Items/Improved Items. For items already in the inventory that have established NC pro rata charges, or for improved items that meet the criteria for NC pro rata charge revision, all U.S. investment costs incurred before the date of calculation of the revised NC recoupment charge will be included in the NC cost pool. Additionally, all users shall be required to pay on an annual basis in proportion to the number of existing items for participation in the program.

(3) Modification Kits. Modification kits are issued to FMS customers and incorporated into end item/major components without the additional NC recoupment charge because the applicable development cost is either included in the end item/major component NC recoupment charge or recouped as program charges on the end item or major components. In exceptional circumstances the user may be assessed an NC charge for any modifications purchased after delivery of the systems. This charge shall be based on 5 percent of the acquisition cost of each modification kit.

(4) Components of Non-MDE End Items. A percentage NC recoupment charge shall be made on any non-MDE item component whenever \$2 million of RDT&E appropriations has been or is expected to be expended on the component. The applicable charge shall be 5 percent of the component's current FMS selling price for components transferred under the FMS program or sold commercially by a U.S. contractor.

E. CALCULATION OF CHARGES FOR TECHNOLOGY SALES

1. Technical Data Packages

a. An NC recoupment charge shall be assessed for the transfer and use of technical data packages (TDPs) to be used to manufacture or produce items for non-USG use. This charge is in addition to normal costs associated with reproduction and shipping of TDPs. Charges for the use of TDPs normally are referred to as royalty fees. However, for MDE items, the approved MDE NC recoupment charge shall be assessed for each item manufactured or coproduced in place of a royalty fee.

b. For a non-MDE item, an NC percentage surcharge shall be applied as the royalty fee on the basis of the item's current DOD inventory price. Prescribed charges for non-MDE items are as follows:

(1) Foreign Governments and non-U.S. Contractors - 5 percent on items manufactured for in-country use and 8 percent on items manufactured for third party use by or on behalf of foreign governments or international organizations.

(2) U.S. Contractors - 3 percent on items manufactured for consumption in the U.S. and 5 percent on items manufactured for export.

c. The above charges will be deemed necessary to constitute the "fair market price" for U.S. technology.

d. A TDP developed with USG funds shall not be released to any non-USG parties, including contractors, unless the recipient has agreed in writing to pay the applicable charges and to pay applicable charges within 30 days after manufacture of applicable items.

SPAWARINST 4920.5
9 January 1990

2. Software. A charge will be made for sales of software whenever \$2 million or more has been, or is expected to be, expended to develop the software regardless of appropriation account. The charge shall be a pro rata charge. The numerator shall be either the number of weapons systems to be supported by the software package or the number of software packages to be duplicated, whichever is the most equitable.

3. Other Technology Transfers. For all other technology transfers, including transfers of TDPs for purposes other than manufacturing, and all transfers of industrial or manufacturing processes, the amount of the charge shall equal the fair market value of the technology involved. For transfers to any U.S. domestic organization, this charge shall be the lower of either:

a. a proportionate share of the DOD investment cost identified to the development of the technical data and technology involved; or

b. a fair market price for the technical data and technology involved based on an engineering analysis of demand or the potential monetary return on investment. For transfers to any non-U.S. contractor or other foreign customer, this charge will be the greater of the foregoing. Accordingly, the lower domestic price shall be applied only if the prospective domestic purchaser signs a written commitment to the Department of Defense that the technical data and technology shall not be transferred to any other party.

F. "SPECIAL" RDT&E AND NONRECURRING PRODUCTION COSTS

1. Particular Customers. The full amount of "special" RDT&E and nonrecurring production costs incurred for the benefit of particular customers shall be paid by those customers. However, when a subsequent purchaser requests the same specialized features that resulted from the added "special" RDT&E and nonrecurring production costs, a pro rata share of these costs may be paid by the subsequent purchaser and transferred to the original customer provided those special nonrecurring costs exceed \$5 million. The pro rata share may be a unit charge determined as a result of distribution of the total costs divided by the total production. Such reimbursements shall not be transferred to the original customer if 8 years have elapsed since acceptance of the Letter of Offer and Acceptance by the original customer, unless otherwise authorized by DSAA. The USG shall not be charged any NC recoupment charge if it adopts the features for its own use or provides equipment containing such features under a U.S. Grant Aid or similar program.

2. Cooperative Undertaking. For coproduction, codevelopment and cooperative production agreements, the policy set forth here generally shall determine the allocation basis for recouping from the third party purchasers the investment costs of the

SPAWARINST 4920.5
9 January 1990

participants. Such agreements shall provide for the application of the policies here to sales to third parties by any of the parties to the agreement and for the distribution of recoupments and technology charges among the parties to the agreement.